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April 15, 1998

Mr. Daren Fields, City Administrator
City of Albany
1000 San Pablo Avenue
Albany, CA 94706-2295

Re: Real Property Transfer Tax - Request for Legal Opinion

Dear Mr. Fields:

This is in reply to your letter of March 2, 1998 addressed to Assistant Chief Counsel Larry Augusta in which you request a legal opinion regarding the effect of a transfer of title to real property for purposes of determining whether it is a transaction subject to the City of Albany's Real Property Transfer Tax. You directed your inquiry to us because one of the provisions of the City of Albany Municipal Code which sets forth an exception to the transfer tax is nearly identical to a Revenue and Taxation Code provision which excludes certain transfers of real property from change in ownership. For that reason, Board staff's interpretation of the application of that change in ownership exclusion to this set of facts is requested as guidance in interpreting the comparable exception to the transfer tax.

Factual Background

C ("C") owned certain real property ("the property") located partly within the City of Albany and partly within the City of Berkeley. C and L, Inc. ("L") proposed to enter into an agreement whereby Ladbroke would receive an option to purchase the property within a specified period of time. As represented by the parties, the transaction was structured as an exchange of property qualifying under the provisions of Internal Revenue Code section 1031.

Under the terms of the proposal, the property was transferred by grant deed to GGF, LLC ("GGF"), a bankruptcy-remote subsidiary entity of C formed on July 25, 1997, for the express purpose of holding, leasing and conveying title to the property and other activities incidental, necessary or appropriate thereto during the term of the option. C holds 100 percent of the economic interests and 99 percent of the voting interests in GGF, L holds a 1 percent voting interest.

Concurrent with the transfer of the property from C to GGF, GGF entered into the option agreement with a subsidiary of L, Golden Gate ("Golden Gate"). The agreement provides that L, through Golden Gate, has the right to purchase the property from GGF upon the occurrence of certain events. If and when Golden Gate exercises the option, GGF will transfer the property to Golden Gate.

The City of Albany Municipal Code section 4-5.1 et seq., titled "Real Property Transfer Tax", provides in section 4-5.2, for the imposition of a tax levied at the rate of eighty-five hundredths (85/100) of one percent (1%) of the value of consideration on

- a. all transfers by deeds, instruments, writings, or any other document by which any lands, tenements, or other interest in real property are sold, assigned, conveyed, transferred, exchanged or title otherwise changed within the City of Albany . . .

Numerous exceptions to the transfer tax are thereafter set forth, including those enumerated in section 4-5.11 which provides, in relevant part

Any tax imposed pursuant to this section shall not apply to transfers, conveyances, leases, or subleases without consideration (exclusive of the value of any lien or encumbrance remaining thereon) which:

- h. Any transfer from an individual(s), legal entity, or trust to a legal entity such as a partnership or a corporation in which shares or interests are owned and which result solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interests, or otherwise, and each and every piece of property owned by the transferor, remain the same after the transfer.

The City of Albany, pursuant to its Municipal Code imposed the transfer tax on the grant deed conveyance of the property from C to GGF. C contests the tax on the ground that C owned 100 percent of the interests in the property prior to the transfer and, because it owns 100 percent of the economic interests in GGF, it owns 100 percent of the interests in the property after the transfer. Thus, C contends that the conveyance falls within the exception noted in subdivision h. of section 4-5.11 as a transfer resulting solely in a change in the method of holding title to the real property and in which the proportional ownership interests held by C remained the same after the transfer.

Change in Ownership Law

Under California property tax law, a transfer of county-assessed real property that results in a "change in ownership" as defined in the Revenue and Taxation Code and gives rise to a new assessed value for that property and, thereby, a new base year value upon which to levy the ad valorem property tax. Revenue and Taxation Code section 60 defines "change in ownership" as "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest"; and section 61 sets forth specific instances of changes in ownership. The code also sets forth various exclusions from "change in ownership", among which is subdivision (a)(2) of section 62. The language of subdivision (a)(2) is remarkably similar to subdivision h. of section 4-5.11 and provides, in part

Change in ownership shall not include:

...
(a) (2) Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, that results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer.

For the reasons set forth below, it is our opinion that the grant deed conveyance of the property from C to GGF would be excluded from change in ownership pursuant to subdivision (a)(2) of section 62. For change in ownership purposes, we view ownership interests in limited liability companies, measured by the members' capital and profit interests, as members' interests in capital and profits. C holds all economic interests in GGF, which interests are represented by capital and profit interests. Thus, the interests in the real property were proportional before and after the transfer, and only the method of holding title to the real property changed.

AnalysisEntity-to-entity transfer is a change in ownership

As stated above, pursuant to section 60, a transfer by grant deed of the fee simple interests in real property results in a change in ownership of those interests transferred. Section 61, subdivision (j) specifically provides

Except as otherwise provided in Section 62, change in ownership, as defined in Section 60, includes, but is not limited to:

- (j) The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person.

Among the provisions which govern the construction of the Revenue and Taxation Code, section 19 defines "person" to include a "limited liability company", such as GGF. Thus, under statutory law, the conveyance from C to GGF clearly resulted in a change in ownership.

Proportional interest transfer exception

Under the circumstances described, the transfer would be excluded from change in ownership if the ownership interests in the real property after the transfer remain proportional to the ownership interests prior to the transfer, pursuant to subdivision (a)(2) of section 62. There is some doubt, apparently, that the ownership interests in the real property remain proportional after the transfer to GGF because, though C owns 100 percent of the economic interests in GGF, it holds only 99 percent of the voting interests while L holds the other 1 percent voting interest. However, for change in ownership purposes, Board staff have taken the view that members' ownership interests in LLCs, measured by the members' capital and profit interests, are the members' interests in capital and profits, the same as is the case for partners' ownership interests in partnerships. An exception would be if the ownership interests in an LLC were measured by corporate shares and the LLC classified itself as a corporation for federal income tax purposes. Such is not the case in this instance, however.

GGF's operating agreement provides that only C shall hold economic interests in GGF, L receives and holds only a voting interest. Paragraph 1.12 of the agreement defines "economic interests" as "net profits, net losses, Tax Credits, Distributable Cash or other Distributions". That provision is consistent with the Corporations Code section 17001 which states, in part, that

- (n) "Economic interest" means a person's right to share in the income, gains, losses, deductions, credit, or similar items of, and to receive distributions from, the limited liability company, but does not include any other rights of a member, including, without limitation, the right to vote or to participate in management, . . .

Paragraph 3.1 of the agreement further specifies that only C shall make a capital contribution and that L "shall not make a capital contribution and shall have no Economic Interest" in GGF. In view of the fact that C holds 100 percent of the interests in capital and profits in GGF, the transfer of real property would be excluded from change in ownership because it resulted in a change in the method of holding title while the proportional interests in the property remained the same as contemplated by subdivision (a)(2) of section 62.

April 15, 1998

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

A handwritten signature in black ink, appearing to read "Louis Ambrose", with a long horizontal flourish extending to the right.

Louis Ambrose
Tax Counsel

LA:ba

cc: Mr. Dick Johnson, MIC:63
Mr. Rudy Bischof, MIC:64
Mr. David Gau, MIC:64
Ms. Jennifer Willis, MIC:70

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